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7535-01-U

NATIONAL CREDIT UNION ADMINISTRATION

12 CFR Part 745

RIN 3133-AD18

Share Insurance and Appendix

AGENCY: National Credit Union Administration (NCUA).

ACTION: Final rule.

SUMMARY: NCUA is amending its share insurance rules to implement amendments to the Federal Credit Union Act (FCU Act) made by the Federal Deposit Insurance Reform Act of 2005 (Reform Act) and the Federal Deposit Insurance Reform Conforming Amendments Act of 2005 (Conforming Amendments Act). In this regard, the final rule: 1) defines the “standard

maximum share insurance amount” as \$100,000 and provides that beginning in 2010, and in each subsequent 5-year period thereafter, NCUA and the Federal Deposit Insurance Corporation (FDIC) will jointly consider if an inflation adjustment is appropriate to increase that amount; 2) increases the share insurance limit for certain retirement accounts from \$100,000 to \$250,000, subject to the above inflation adjustments; and 3) provides pass-through coverage to each participant of an employee benefit plan, but limits the acceptance of shares in employee benefit plans to insured credit unions that are well capitalized or adequately capitalized. Additionally, NCUA is amending its share insurance rules to clarify insurance coverage for qualified tuition savings programs, commonly referred to as 529 plans, and share accounts denominated in foreign currencies.

DATES: This final rule is effective [Insert date 30 days following publication in the FEDERAL REGISTER].

FOR FURTHER INFORMATION CONTACT: Frank Kressman, Staff Attorney, Office of General Counsel, or Moissette Green, Staff Attorney, Office of General Counsel, at the above address or telephone: (703) 518-6540.

SUPPLEMENTARY INFORMATION:

A. Federal Deposit Insurance Reform Act of 2005 and Federal Deposit Insurance Reform Conforming Amendments Act of 2005

The Reform Act and Conforming Amendments Act, (Pub. L. 109-171) and (Pub. L. 109-173), amended the share insurance provisions of the FCU Act in a number of ways. 12 U.S.C. 1781-1790d. Specifically, section 2103(a) of the Reform Act provides that beginning April 1, 2010, and each subsequent 5-year period thereafter, NCUA and the FDIC will jointly consider if an inflation adjustment is appropriate to increase the NCUA's current "standard maximum share insurance amount" (SMSIA), which is defined in 12 U.S.C. 1787(k) as \$100,000, and the "standard maximum deposit insurance amount" (SMDIA), the FDIC equivalent. Any increase to the SMSIA or SMDIA will be calculated using a formula comparing, over time, the published annual values of the Personal Consumption Expenditures Chain-Type Price Index, published by the Department of Commerce, and rounded down to the nearest \$10,000. The Reform Act also requires NCUA and FDIC to consider certain other factors in determining whether to increase the SMSIA and SMDIA. Additionally, if an adjustment is warranted, NCUA and FDIC are required to publish information in the Federal Register and provide a corresponding report to Congress by April 5, 2010, and every succeeding fifth year. Subsequently, under those circumstances, an inflation adjustment will take effect on January 1st of the year immediately succeeding the year in which the adjustment is calculated unless an act of Congress provides otherwise.

Section 2(d)(1)(C) of the Conforming Amendments Act mandates that NCUA provide "pass-through" share insurance coverage for shares in any employee

benefit plan account on a per-participant basis. This type of coverage is called “pass-through” because it passes through the employee benefit plan administrator to each of the participants in the plan. The employee benefit plans to which this section refers include those described in: 1) section 3(3) of the Employee Retirement Income Security Act of 1974; 2) section 401(d) of the Internal Revenue Code (IRC); and 3) section 457 of the IRC. This section, however, limits the acceptance of employee benefit plan shares to insured credit unions that are “well capitalized” or “adequately capitalized” as those terms are defined in section 216(c) of the FCU Act. 12 U.S.C. 1790d(c).

Section 2(d)(2) of the Conforming Amendments Act amended 12 U.S.C. 1787(k)(3) of the FCU Act to increase the share insurance limit for certain retirement accounts from \$100,000 to \$250,000. The increased limit is also subject to the inflation adjustments discussed above. The types of accounts within this category of coverage include those specifically enumerated in 12 U.S.C. 1787(k)(3): individual retirement accounts (IRAs) described in section 408(a) of the IRC and any plan described in section 401(d) of the IRC (Keogh accounts).

Additionally, the Conforming Amendments Act created the term “government depositor” in connection with public funds described in and insured under 12 U.S.C. 1787(k)(2). It also provides that the shares of a government depositor are insured in an amount up to the SMSIA. The amendments to NCUA’s share

insurance rules in part 745 implement the share insurance coverage revisions made by the Reform Act and the Conforming Amendments Act.

B. Interim Final Rule

In March 2006, the NCUA Board issued an interim final rule with request for comments to implement the statutory amendments summarized above. 71 FR 14631 (March 23, 2006). It put in place share insurance rules, effective on April 1, 2006, that enhance share insurance coverage, clarify legal positions already taken by NCUA, maintain parity with the FDIC, and are consistent with the regulatory changes FDIC made under the Reform Act and Conforming Amendments Act. Additionally, the interim final rule clarified and incorporated prior interpretations of the share insurance rules that provide coverage for qualified tuition savings plans created pursuant to section 529 of the IRC (529 plans) and share accounts denominated in foreign currencies.

C. Summary of Comments

NCUA received 14 comments regarding the interim rule: three from FCUs, six from state credit unions, two from credit union trade associations, and three from a professional association of state and territorial regulatory agencies. All 14 commenters supported the rule.

Two commenters, while supporting the rule in general, limited their comments to NCUA's clarification of share insurance coverage for shares denominated in foreign currency. One of those commenters also requested NCUA permit credit

unions to invest foreign currencies received from members at pre-approved corporate credit unions. Permissible investments for FCUs are beyond the scope of this rulemaking, but the Board may consider this authority in other rulemakings.

The other twelve commenters supporting the rule responded to NCUA's request for comments on whether pass-through coverage for employee benefit plans should depend on the participants' membership in the credit union where the employee benefit plan is maintained. All agreed share insurance coverage should be extended to all participants of the employee benefit plan regardless of the participants' membership in the credit union. Many of the commenters noted that: 1) employers generally establish employee benefit plans at credit unions where there is already some membership connection; 2) participants may not control where their interests in the employee benefit plan are deposited; and, 3) the Conforming Amendments Act prohibits credit unions that are not well or adequately capitalized from accepting employee benefit plan shares.

Seven commenters requested NCUA extend pass-through coverage to attorney trust accounts commonly known as IOLTA accounts (interest-on-lawyer-trust accounts) in a fashion similar to employee benefit plans accounts. These comments are beyond the scope of this rulemaking. The Conforming Amendments Act does not address IOLTA accounts, and NCUA will continue to insure IOLTA accounts by providing pass-through coverage only to members.

D. Standard Maximum Share Insurance Amount

The interim final rule added a definition of SMSIA to §745.1, the definitions section of the share insurance rules. 12 CFR 745.1. The definition of SMSIA tracks the language of the Conforming Amendments Act and reads “\$100,000, adjusted as provided under section 11(a)(1)(F) of the Federal Deposit Insurance Act.” 12 U.S.C. 1821 (a)(1)(F). Revised section 11(a)(1)(F) of the Federal Deposit Insurance Act details how every five years, the NCUA and FDIC will consider and calculate the inflation adjustment to the SMSIA and SMDIA, as discussed above. Also, the definition of SMSIA notes: 1) the current SMSIA is \$100,000; 2) the acronym SMSIA is used throughout the regulatory text of part 745; and 3) all examples of share insurance coverage in part 745 use the current SMSIA of \$100,000, unless a higher limit is presented and specifically noted. Accordingly, all references to the current insurance amount of \$100,000 in the appendix to part 745, except for the examples in the appendix, are replaced by the acronym SMSIA. Examples in the appendix to part 745, which NCUA believes are helpful in illustrating a member’s insurance coverage, will continue to provide the dollar amount of insurance for the particular example so members can calculate and know the insurance available on their accounts. The use of the acronym SMSIA throughout the regulatory text of part 745, instead of an actual number, will allow NCUA to avoid having to change the numerical limit of share insurance throughout the rule each time the SMSIA is adjusted for inflation.

The amendments regarding the SMSIA in the interim final rule are adopted in this final rule without change.

E. Retirement and Other Employee Benefit Plan Accounts

In implementing amendments to the FCU Act by the Conforming Amendments Act, the interim final rule consolidated §745.9-3 into §745.9-2. This section now addresses share insurance coverage for IRA/Keogh accounts and deferred compensation accounts, establishes pass-through insurance coverage for employee benefit plan accounts, and increases share insurance coverage to \$250,000 for certain retirement accounts.

Although the Conforming Amendments Act prohibits insured credit unions that are not “well capitalized” or “adequately capitalized” from accepting employee benefit plan shares, pass-through coverage is granted for shares in employee benefit plan accounts in existence before this rule even if the credit unions do not meet the requisite capital levels. Credit unions that do not meet the requisite capital levels, or those that previously met the requisite capital levels but fall below those levels, are prohibited from accepting shares in employee benefit plan accounts until their capital levels improve.

Previously, full share insurance coverage in an employee benefit plan, such as a deferred compensation account, had been limited to plan participants who are also members of the credit union in which the account is maintained. In the interim final rule, NCUA noted that, during the rulemaking process, it intended to

continue to insure employee benefit plan participants in accordance with the example for retirement funds then provided in the appendix to NCUA's insurance rule. 12 CFR Part 745, Appendix, Paragraph G, Examples 3(a) and 3(b). That meant participants in an employee benefit plan who are credit union members would receive up to \$100,000 as to their determinable interest but member interests not capable of evaluation and nonmember interests would be added together and insured up to \$100,000 in the aggregate.

NCUA also noted in the interim final that the language of the Conforming Amendments Act suggests greater NCUA authority to provide pass-through coverage on a per-participant basis, regardless of membership status. Specifically, the Conforming Amendments Act defines pass-through insurance as "insurance coverage based on the interest of each participant" without including any limitations or qualifications requiring the membership status of each participant. Federal Deposit Insurance Reform Conforming Amendments Act of 2005, Pub. L. 109-173. Also, the legislative history of the Reform Act evidences congressional intent to advance as a national priority the enhancement of retirement security for all Americans. H.R. Rep. No. 109-67 at 22 (2005).

On those bases, and in consideration of the comments received, NCUA believes it is appropriate to extend full coverage to all participants in an employee benefit plan. NCUA does not believe it is necessary to restrict this extended coverage only to plans where the plan trustee or the employer sponsoring the plan is a

member or if some percentage of plan participants are members. NCUA finds the language of the Conforming Amendments Act does not impose any membership restrictions and supports the agency's position.

Furthermore, NCUA believes extending full coverage to all participants, regardless of membership status, is both fair and reasonable for two additional reasons. First, it is extremely likely that employers or trustees will only establish employee benefit plans at a credit union if there is already some membership connection, for example, the employee group is within the field of membership of the credit union. Second, participants may not be able to control or readily determine where their interests in an employee benefit plan are maintained. Therefore, as a matter of fairness to participants, all should be assured of full, pass-through coverage. As discussed above, NCUA will extend full pass-through coverage to member and nonmember participants alike. Accordingly, examples 3(a) and (b) in paragraph G of the appendix are revised to illustrate the pass-through coverage provided to employee benefit plans.

F. Public Unit Accounts

The interim final rule changed the heading of §745.10 from "Public Unit Accounts" to "Accounts Held By Government Depositors" to reflect the amendments to 12 U.S.C. 1787(k)(2) by the Conforming Amendments Act. The interim rule did not make any substantive changes to §745.10 other than replacing references to \$100,000 with references to the SMSIA. The

amendments regarding public unit accounts in the interim rule are adopted in this final rule without change.

G. 529 Programs

Section 529 of the IRC provides tax benefits for 529 plans. 26 U.S.C. 529(a).

These programs include prepaid tuition programs, which educational institutions may create, as well as tuition savings programs that states or public instrumentalities sponsor. 26 U.S.C. 529(b)(1). Section 529 defines a tuition savings program as a program under which a person “may make contributions to an account which is established for the purpose of meeting the qualified higher education expenses of the designated beneficiary of the account” and which meets certain requirements. 26 U.S.C. 529(b)(1)(A)(ii). A participant in a 529 program acquires an interest in a state trust and does not directly deposit funds with a financial institution.

In April 2005, a state contacted NCUA about share insurance coverage for its 529 plan. The state asked NCUA to adopt a rule similar to the FDIC’s interim final rule to allow pass-through coverage for participants in the 529 program. 70 FR 33689 (June 9, 2005). The FDIC’s interim final rule provided pass-through coverage to each participant aggregated with the participant’s other single ownership accounts at the same financial institution up to \$100,000, provided that each deposit may be traced to one or more particular investors and the

FDIC's disclosure rules for pass-through coverage had been satisfied. 70 FR at 33691.

NCUA's Office of General Counsel (OGC) issued a legal opinion concluding that NCUA's insurance rules provide pass-through coverage to a 529 program participant if the participant is a member of the federally insured credit union where the 529 program account is maintained and if the account is properly titled. OGC Legal Opinion 05-0630 (July 1, 2005). This interpretation of the NCUA rule reached the same result in terms of coverage and maintained parity with the deposit insurance provided by the FDIC in its interim rule, although on a slightly different basis. The legal opinion also noted that NCUA would consider amending its insurance rule when FDIC issued a final one. Id. In October 2005, FDIC issued a final rule without any substantive changes. The interim rule incorporated OGC Legal Opinion 05-0630 into part 745 to clarify that share insurance coverage is available for 529 program participants.

In 529 programs of which NCUA is aware, the state holds 529 program funds as an agent for the participants. Accordingly, these accounts are insured as single ownership accounts under NCUA's share insurance rule covering accounts held by agents or nominees. 12 CFR 745.3(a)(2).

Agent or nominee accounts are insured as individual accounts and are aggregated with all other individual accounts a participant has at the same credit

union up to the SMSIA. To be fully insured, the participant's interest must be ascertainable from the credit union's or state's records. 12 CFR 745.2(c)(2). Therefore, careful titling of the accounts and proper records are necessary to ensure each participant receives individual account coverage. NCUA insurance regulations require a participant to be a member of the credit union or otherwise eligible to maintain an insured account in the credit union. 12 CFR 745.0. The amendments regarding 529 programs in the interim rule are adopted in this final rule without change.

H. Share Accounts Denominated in a Foreign Currency

The FCU Act authorizes the NCUA Board to limit the type of share payments a credit union may accept and to determine the types of funds that will be insured. 12 U.S.C. 1766, 1782, 1782(h)(3). If NCUA permits federal credit unions (FCUs) to accept member accounts denominated in a foreign currency, then NCUA must insure them. 12 U.S.C. 1781(a). Under the FCU Act's nondiscrimination provision, NCUA must provide the same coverage for member accounts of state-chartered credit unions that comply with the FCU Act and NCUA regulations. Id.; 12 U.S.C. 1790.

Under the incidental powers rule, FCUs can provide monetary instrument services that enable members to purchase, sell, or exchange various currencies. 12 CFR 721.3(i). FCUs can use their accounts in foreign financial institutions to facilitate transfer and negotiation of member share drafts denominated in foreign

currencies or engage in monetary transfer services. FCU funds deposited in a foreign financial institution are not insured by NCUA and may not be insured by the foreign country. Consequently, NCUA has highlighted the need for FCUs to exercise due diligence to ensure the foreign financial institutions with which it has accounts are financially sound, suitably regulated, and authorized to accept its transactions before opening any accounts. OGC Legal Opinion 99-1031 (December 9, 1999). FCUs assume the risk of currency fluctuations when they maintain an account in a foreign financial institution. NCUA recognized this risk and, before adopting §721.3(i), had recommended FCUs either purchase or deposit only the amount of foreign currency needed to satisfy immediate short-term needs of their members. OGC Legal Opinions 99-1031 (December 9, 1999); 90-0637 (June 29, 1990).

While the FCU Act does not prohibit FCUs from accepting foreign-denominated shares, potential safety and soundness concerns associated with currency fluctuations have kept FCUs from offering these accounts. Accordingly, NCUA has only permitted FCUs to provide foreign currency services as an incidental powers activity rather than allowing FCUs to maintain shares in foreign currency. See OGC Legal Opinions 89-0822 (September 15, 1989); 89-0613 (July 31, 1989). Simply accepting shares denominated in a foreign currency presents little risk, if any, to credit unions. NCUA believes federally insured credit unions can effectively manage the risks associated with accepting shares denominated in foreign currency and issued provisions similar to the FDIC's in the interim final

rule. Lending or investing funds in foreign currency still presents an increased risk to credit unions due to currency fluctuations that cannot be easily ameliorated, so the interim final rule did not permit lending or investing funds denominated in a foreign currency.

Previously, NCUA had not expressly addressed the insurability of member accounts denominated in foreign currency except in the foreign branching regulation, where NCUA has limited the insurability of member accounts at foreign branches of an insured credit union to accounts denominated in U.S. dollars. 12 CFR 741.11(e). The interim final rule provided share insurance coverage for shares denominated in a foreign currency and for conversion of foreign currency to U.S. dollars before an insurance payout in the event a credit union is liquidated similarly to the FDIC.

The FDIC provides insurance coverage for deposits at insured banks denominated in a foreign currency equal to the amount of U.S. dollars equivalent in value to the amount of the deposit denominated in the foreign currency up to the SMDIA. 12 CFR 330.3(c). Under the FDIC rule, if an insured bank is liquidated, the value of the foreign currency deposit is determined using the rate of exchange quoted by the Federal Reserve Bank of New York at noon on the day the bank defaults, unless the deposit agreement states otherwise. Id. Deposits payable solely outside of the U. S. and its territories are not insurable deposits. 12 CFR 330.3(e).

As noted above, accepting shares denominated in a foreign currency presents little risk. If a credit union is able to fund an operation that is fully integrated and supportable in foreign currency, it will have minimized its exposure to risk of loss due to currency fluctuation. Actually, the risk would shift to the members who deposit and withdraw funds denominated in the foreign currency.

The interim final rule permitted credit unions to accept shares denominated in foreign currency and provided share insurance coverage of those shares. By accepting shares denominated in foreign currencies, credit unions can better serve members who, for example, receive payments in foreign currencies. Additionally, members who deposit shares denominated in a foreign currency will have the same share insurance coverage available for share accounts denominated in U.S. dollars. Credit unions must carefully consider any risk associated with maintaining shares denominated in foreign currencies before offering this service to their members. Federally insured credit unions that maintain shares denominated in a foreign currency will receive instructions on how to report these deposits on 5300 call reports.

The interim final did not permit insured credit unions to make loans or invest funds denominated in foreign currencies. These transactions may require credit unions to participate in trading currency, also called hedging or currency swaps, to manage the risk of potential loss due to currency fluctuations. While hedging

may help credit unions protect against risks associated with changing currency rates, NCUA rules currently prohibit natural person FCUs from investing in derivatives like currency swaps. 12 C.F.R. 703.16(a). FCUs that wish to engage in swaps to hedge against currency fluctuation must apply for NCUA approval as a part of a properly designed investment pilot program. 12 C.F.R. 703.19. This rulemaking only addresses share insurance coverage. During NCUA's annual regulatory review, staff will consider the investments rules in part 703 and may recommend amendments to FCU investment authority. The amendments regarding share accounts denominated in a foreign currency in the interim final rule are adopted in this final rule without change.

REGULATORY PROCEDURES

Regulatory Flexibility Act

The Regulatory Flexibility Act requires NCUA to prepare an analysis to describe any significant economic impact a rule may have on a substantial number of small credit unions, defined as those under ten million dollars in assets. This final rule clarifies and improves available share insurance coverage, without imposing any regulatory burden. The final amendments would not have a significant economic impact on a substantial number of small credit unions, and, therefore, a regulatory flexibility analysis is not required.

Paperwork Reduction Act

NCUA has determined that this final rule would not increase paperwork requirements under the Paperwork Reduction Act of 1995 and regulations of the Office of Management and Budget.

Executive Order 13132

Executive Order 13132 encourages independent regulatory agencies to consider the impact of their actions on state and local interests. In adherence to fundamental federalism principles, NCUA, an independent regulatory agency as defined in 44 U.S.C. 3502(5), voluntarily complies with the executive order. This final rule would not have substantial direct effects on the states, on the connection between the national government and the states, or on the distribution of power and responsibilities among the various levels of government. NCUA has determined that this rule does not constitute a policy that has federalism implications for purposes of the executive order.

The Treasury and General Government Appropriations Act, 1999 - - Assessment of Federal Regulations and Policies on Families

The NCUA has determined that this final rule would not affect family well-being within the meaning of section 654 of the Treasury and General Government Appropriations Act, 1999, Pub. L. 105-277, 112 Stat. 2681 (1998).

Small Business Regulatory Enforcement Fairness Act

The Small Business Regulatory Enforcement Fairness Act of 1996 (Pub. L. 104-121) (SBREFA) provides generally for congressional review of agency rules. A reporting requirement is triggered in instances where NCUA issues a final rule as defined by Section 551 of the Administrative Procedure Act. 5 U.S.C. 551. The Office of Management and Budget has determined that this final rule is not a major rule for purposes of SBREFA.

List of Subjects

12 CFR part 745

Credit unions, Share insurance.

By the National Credit Union Administration Board on September 21, 2006.

Mary F. Rupp

Secretary of the Board

Accordingly, NCUA adopts the interim rule amending 12 CFR part 745, which was published at 71 FR 14631 on March 23, 2006, as a final rule with the following change:

PART 745 — SHARE INSURANCE AND APPENDIX

1. The authority citation for part 745 continues to read as follows:

Authority: 12 U.S.C. 1752(5), 1757, 1765, 1766, 1781, 1782, 1787, 1789.

2. The Appendix to Part 745 is amended by revising Examples 3(a) and 3(b) of Paragraph G to read as follows:

APPENDIX TO PART 745-EXAMPLES OF INSURANCE COVERAGE AFFORDED ACCOUNTS IN CREDIT UNIONS INSURED BY THE NATIONAL CREDIT UNION SHARE INSURANCE FUND

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G. How are Trust Accounts and Retirement Accounts Insured?

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Example 3(a)

Question: Member T invests \$500,000 in trust for ABC Employees Retirement Fund. Some of the participants are members and some are not. What is the insurance coverage?

Answer: The account is insured as to the determinable interests of each participant to a maximum of \$100,000 per participant regardless of credit union member status. T's member status is also irrelevant. Participant interests not capable of evaluation shall be added together and insured to a maximum of \$100,000 in the aggregate (§745.9–2).

Example 3(b)

Question: T is trustee for the ABC Employees Retirement Fund containing \$1,000,000. Fund participant A has a determinable interest of \$90,000 in the Fund (9% of the total). T invests \$500,000 of the Fund in an insured credit union and the remaining \$500,000 elsewhere. Some of the participants of the Fund are members of the credit union and some are not. T does not segregate each participant's interest in the Fund. What is the insurance coverage?

Answer: The account is insured as to the determinable interest of each participant, adjusted in proportion to the Fund's investment in the credit union, regardless of the membership status of the participants or trustee. A's insured interest in the account is \$45,000, or 9% of \$500,000. This reflects the fact that only 50% of the Fund is in the account and A's interest in the account is in the same proportion as his interest in the overall plan. All other participants would be similarly insured. Participants' interests not capable of evaluation are added together and insured to a maximum of \$100,000 in the aggregate (§745.9–2).

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